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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	CC Docket No. 97-158
Southwestern Bell Telephone Company	)	Transmittal No. 2633
Tariff F.C.C. No. 73	)	

OPPOSITION OF TIME WARNER COMMUNICATIONS HOLDINGS INC.

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COMMUNICATIONS HOLDINGS INC.

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Time Warner Communications Holdings Inc. ("TWComm"), by its attorneys, hereby files its Opposition to the Petition for Reconsideration ("Petition") filed by Southwestern Bell Telephone Company ("SWBT") of the FCC's denial of the above-captioned tariff filing.[1]

INTRODUCTION AND SUMMARY

In Transmittal No. 2633, SWBT proposed an amendment to its interstate access tariff that would have permitted the company to offer below-tariff prices for interstate access services to any carrier that issued a request for proposal ("RFP"). It was clear that this proposal violated the Commission's rules against discriminatory pricing. But SWBT argued that the Commission was compelled by its own precedents to apply the competitive necessity doctrine to this case, that the doctrine constituted a complete defense against anti-discrimination rule violations and

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[1] See Order Concluding Investigation and Denying Application for Review, CC Dkt. No. 97-158, FCC 97-394 (rel. Nov. 14, 1997) ("RFP Tariff Rejection Order").

that indeed SWBT met the three prong standard of the competitive necessity doctrine.[2] In the RFP Tariff Rejection Order, the Commission held that the competitive necessity doctrine does not apply to incumbent LECs, and rejected Transmittal No. 2633 as a violation of its anti-discrimination rules.

SWBT's Petition offers no basis for reversing that decision. As the Commission found, its precedents in no way require it to apply the competitive necessity doctrine to incumbent LECs. The Commission has simply never decided the specific issue of whether that doctrine should be applied to firms like SWBT that control bottleneck local exchange facilities. It was therefore fully within the Commission's discretion to determine in this proceeding whether the doctrine should be available to SWBT as a defense to FCC prohibitions on discriminatory pricing practices. Moreover, SWBT has offered no basis for concluding that the Commission's precedents even support by analogy the application of the competitive necessity doctrine.

The Commission's decision was based on a rational and wise exercise of its discretion. The Commission considered both the costs and the benefits of permitting incumbent LECs the flexibility to discriminate among individual access customers.

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[2] The doctrine requires that a carrier demonstrate that (1) equally or lower priced competitive alternatives are generally available to customers of the discounted offering; (2) the discounted offering responds to competition without undue discrimination; and (3) the discount contributes to reasonable rates and efficient services for all users. See Private Line Rate Structure and Volume Discount Practices, CC Dkt. No. 79-246, *Report and Order*, 97 F.C.C.2d 923 (1984).

While recognizing certain possible benefits, it sensibly concluded that the potential cost of permitting extensive pricing flexibility at this early stage in the development of access competition was simply too great. Underlying that conclusion is the fundamental truth that the dynamic efficiencies that competition will introduce (if permitted to develop) far outweigh the static, short-term efficiencies that *may* be gained from allowing SWBT to charge lower access prices to certain select customers. Indeed it is even less likely that RFP pricing flexibility for SWBT will benefit access customers if SWBT's challenge to the constitutionality of Section 271-275 is ultimately successful.

SWBT has offered no factual evidence for rethinking this conclusion. It's only new contribution to the discussion is an affidavit that provides a limited and misleading analysis of the consequences of permitting SWBT to respond to RFPs.

SWBT last argues that the rejection order will prevent it from even competing in certain markets. Given the substantial amount of pricing flexibility that it already possesses and its historic success in protecting its core in-region market, this claim should not be taken seriously.

I. THE COMMISSION MAY EXERCISE ITS BROAD DISCRETION TO DETERMINE WHETHER TO APPLY THE COMPETITIVE NECESSITY DOCTRINE TO TRANSMITTAL NO. 2633.

As the Commission aptly notes in its RFP Tariff Rejection Order, "Commission precedent does not address the specific circumstances at issue [in the Transmittal No. 2633] and therefore does not require application of the competitive

necessity doctrine for the individualized tariff offerings that Transmittal No. 2633 would permit."[3] In addition, SWBT fails to demonstrate that the Commission is otherwise constrained in its decisionmaking authority. As such, the Commission retains its typical broad discretion in this instance.

SWBT has now abandoned its previous position that Commission precedent compels it to apply the competitive necessity doctrine in this instance. The Commission need not therefore expend any resources to revisit its decision in this regard.[4] Instead, SWBT merely argues that "applicable precedent supports use of the competitive necessity doctrine in this case."[5] But SWBT provides no evidence to bolster its assertion that Commission precedent indicates that it should exercise its discretion any differently than it did in its RFP Tariff Rejection Order.

First, SWBT argues that no Commission precedent forecloses the Commission from permitting a LEC to rely on the competitive necessity doctrine in the present circumstance.[6] This is technically true, although the Commission's decision to apply the substantial competition standard to AT&T's request for contract

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3 RFP Tariff Rejection Order at ¶ 31.

4 See id. at ¶ 40 ("In summary, our precedent does not compel us to apply the competitive necessity doctrine in this case.")

5 Petition at 3 (emphasis added).

6 See Petition at 3 (regarding Private Line Guidelines Order); at 3 (regarding OCP Guidelines Order); and at 4 (discussing competitive necessity precedent generally).

tariff authority provides strong support for applying that standard (modified as is appropriate for the exchange access market), rather than the competitive necessity test, to incumbent LEC contract tariffs.[7]

Second, SWBT cites several inapposite cases in which the Commission has applied the competitive necessity doctrine to requests to price "off-tariff" in the interstate interLATA market.[8] AT&T Communications Tariff FCC No. 15 Competitive Pricing Plan No. 2 Resort Condominiums International, CC Dkt. 90-11, *Memorandum Opinion and Order*, 6 FCC Rcd. 5648 (1991) ("AT&T Tariff 15 Order") provides an illustrative example. In that Order, AT&T argued that its tariff was justified pursuant to the competitive necessity doctrine. The Commission found the tariff to be an unlawful price signaling scheme, and therefore did not reach the question of whether AT&T satisfied the competitive necessity doctrine.[9] On appeal, the D.C. Circuit remanded the case, but the tariff ultimately "went into effect by operation of law."[10] As such, the Commission never explicitly addressed

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7 As TWComm explained in its opposition, the Commission has found that RFP responses are contract tariffs. Thus, the Commission's decision to apply the substantial competition standard to AT&T contract tariffs is the closest FCC precedent to the instant situation. See TWComm Opposition at 6.

8 See Petition at 3 (discussing Telpak Proceedings); at 3 (discussing Private Line Guidelines Order); at 4 (discussing AT&T CPP Order); and at 4 (discussing AT&T Tariff 15 Order).

9 AT&T Tariff 15 Order at ¶ 16.

10 RFP Tariff Rejection Order at fn. 105.

AT&T's competitive necessity justification. Moreover, the case concerned the interstate interLATA marketplace. Contrary to SWBT's conclusion,[11] this case provides little guidance with respect to the local market since each of the three prongs of the competitive necessity doctrine is intricately tied to the factual circumstances concerning, among other things, the markets and carriers involved.

Third, SWBT mischaracterizes the Commission's discussion of the DS-3 ICB Order in the RFP Tariff Rejection Order, and concludes that the Commission "acknowledges that the competitive necessity doctrine is available to justify the reasonableness of potentially discriminatory offerings of dominant carriers."[12] This interpretation is incorrect. The RFP Tariff Rejection Order makes perfectly clear that, in the DS-3 ICB Order, "the Commission reviewed and rejected incumbent LECs' invocation of the competitive necessity doctrine without considering the threshold issue of whether the defense should apply to single-customer offerings."[13]

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11 See Petition at 4 ("[T]he AT&T Tariff 15 case appears to even more directly support SWBT's arguments").

12 Id. at 3-4.

13 RFP Tariff Rejection Order at ¶ 7 (emphasis added). Subsequent Commission discussion of its competitive necessity precedent confirms the Commission's action in the DS-3 ICB Order: "[t]he Commission has never addressed the issue of a competitive necessity justification with respect to access services of dominant LECs." In the Matter of Southwestern Bell Telephone Company, Tariff F.C.C. No. 73, CC Dkt. No. 95-140, *Order Terminating Investigation*, 11 FCC Rcd. 1215 at ¶ 25 (1995). SWBT characterized this case as

Finally, SWBT argues that all competitive necessity cases "should be examined in light of the Decreased Regulation of Basic Telecommunications Services proceeding's tentative conclusion to allow [individual contract tariffs] to take effect."[14] In the NPRM in that proceeding, the Commission tentatively concluded that "tariff regulation for contract services provided by dominant carriers should be streamlined."[15] Nevertheless, the Commission also rightly noted that "a dominant carrier could have both the ability and the incentives to take anticompetitive actions in the contract services submarket that harm ratepayers of its other network services as well as its competitors . . . ."[16]

In any case, since the conclusions relied upon by SWBT were merely tentative, they were not derived from industry comments, and thus provide no precedent. Moreover, the Commission itself ultimately terminated the proceeding and cast doubt upon the

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offering "no precedential value" since the proceeding remains pending on remand before the Commission. While this may be technically true, the fact remains that the D.C. Circuit took no issue with the Commission's interpretation of its own precedent. See Southwestern Bell Telephone Co. v. FCC, 100 F.3d 1004, 1008 (D.C. Cir. 1996) (remanding to the Commission for additional explanation as to such issues as the amount of competition required to satisfy the competitive necessity doctrine).

14 Petition at 5.

15 In the Matter of Decreased Regulation of Certain Basic Telecommunications Services, CC Dkt. No. 86-421, *Notice of Proposed Rulemaking*, 2 FCC Rcd. 645 at ¶ 35 (1987).

16 Id.

value of these tentative conclusions, stating that "the record . . . has become stale."[17]

SWBT is understandably disappointed by the Commission's decision that the competitive necessity doctrine does not apply to Transmittal No. 2633. Nevertheless, the question presented by the petition for reconsideration is whether the Commission erred in refusing to so apply the doctrine. It did not. SWBT has failed to present any new evidence or rationale demonstrating why Commission precedent somehow narrows the Commission's otherwise broad authority in this area.

II. SWBT HAS PROVIDED NO BASIS IN SOUND POLICY FOR REVERSING THE FCC'S REASONABLE EXERCISE OF ITS DISCRETION TO REJECT THE RFP TARIFF.

As the Commission explained in the RFP Tariff Rejection Order,

> Transmittal 2633 allows SWBT a virtually unlimited opportunity to preempt new market entrants in its territory by reducing rates to individual customers to which it believes new entrants may make offers, without making those rates available to similarly situated customers elsewhere.[18]

Indeed, it would be hard to devise a more effectively designed vehicle for strategic or predatory pricing than the RFP tariff provision SWBT proposed. As the Commission found, the RFP provision would have allowed SWBT to drop its access prices anywhere in its region in response to individual RFPs, with

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[17] In the Matter of Decreased Regulation of Certain Basic Telecommunications Services, *Order*, CC Dkt. No. 86-421, 5 FCC Rcd. 5412 at ¶ 3 (1990).

[18] See RFP Tariff Rejection Order at ¶ 42.

essentially no obligation to offer the same price to any other purchaser of access services.[19] Moreover, the broad definition of an "RFP" contained in the proposed provision would have permitted SWBT to offer individual price reductions to virtually any customer.[20] Thus, SWBT would have received virtually complete discretion to determine when and where to drop its prices.

As TWComm explained in its opposition to Transmittal 2633, granting such extraordinary pricing flexibility to a firm with a dominant share of the access market will almost certainly be more harmful than beneficial to competition. The characteristics of the access market make it especially susceptible to strategic or predatory behavior. The high sunk costs required for facilities-based entry and the new entrants' general reliance on a small number of large customers gives the entrenched monopolist an opportunity to selectively drop prices to deter or discipline entry. Moreover, the rate of return aspects of the current federal and state price cap schemes offer SWBT the opportunity to recoup partially or completely any losses associated with predatory or strategic pricing. The "cost" of those strategies to SWBT is therefore likely to be lower than with unregulated firms.

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19 See id. at ¶ 44.

20 See id. at ¶ 45.

A. SWBT Has Provided No Factual Support To Justify Its Request For Approval Of The Commission's Rejection Of Transmittal 2633.

In its Petition, SWBT crudely mischaracterizes the record in the proceeding in an attempt to show that the Commission's rejection of Transmittal 2633 was unjustified. SWBT claims that the "vast majority of the expert evidence filed in this matter" supports approving the tariff. But SWBT confuses volume with probative value. It relies on three pieces of "expert testimony," not one of which provides any genuine support for its position that pricing flexibility is in the public interest.

First, as TWComm explained in its opposition and as the Commission concluded, the law review article written by three SWBT employees and attached to Transmittal 2633 is inapposite to the local market since it deals solely with conditions in the long distance market. There is no need to reargue this issue since SWBT has not made any attempt to refute this conclusion. A similar response is appropriate for SWBT's attempt to explain why the Harris affidavit submitted by U S WEST is of any probative value. SWBT does not mention any reason why the Commission should take it more seriously than before.

The only new contribution SWBT makes in support of its position, the Affidavit of Douglas Mudd (another SWBT employee), does little to advance its cause. The Mudd Affidavit tries to address the Commission's concern regarding the potential for SWBT to abuse pricing flexibility sought in Transmittal 2633. It first argues that efficient entrants will not be deterred from entering so long as "SWBT responses to RFPs yield prices above

the relevant incremental costs."[21] This is a misleading statement. It is no doubt true that a new entrant with sufficiently lower costs than the incumbent *at the time of entry* would not be deterred by prices charged by the incumbent that are above cost but below profit maximizing levels (so-called "limit pricing").[22] But it is also true that limit pricing can deter entry that will lead to increased competition and consumer welfare.[23] In other words, the strategy can deter entry that could eventually develop into lower cost curves for a particular product even if the entrant does not have lower costs at the time of entry. Indeed, the Commission relied on just this possibility, among others, in reaching its decision.

In addition, Mudd dismisses the possibility that "limit pricing" could prevent efficient entry because new entrants will recognize that the dominant firm will not retain prices below

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21 See Mudd Aff. at 6.

22 Limit pricing occurs where a dominant firm charges prices above cost but below profit maximizing levels in order to prevent entry. See III Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 736b1 (1996) ("Areeda & Hovenkamp"). Of course, price cap regulation is itself designed to prevent incumbent LECs from charging rates at profit maximizing levels. The fact remains, however, that the limit price may well be lower than the maximum price levels that are presumed reasonable under a price cap.

23 See id. While limit pricing may not result in a violation of antitrust law, it is well within the FCC's public interest authority to consider and prevent harm to competition that would not concern an antitrust tribunal. See NYNEX/Bell Atlantic, *Memorandum Opinion and Order*, File No. NSD-L-96-10 at ¶ 32 (rel. Aug. 14, 1997) ("The public interest standard, and the competitive analysis conducted thereunder, are necessarily broader than the standard applied to ascertain violations of the antitrust laws.").

profit maximizing levels indefinitely.[24] But the theory of limit pricing rests on the assumption that a dominant firm may have the incentive to lower prices below profit maximizing levels over the long term. The dominant firm would keep prices at these still profitable levels if they deter competitive entry long enough to justify lower profits in the short term.[25] It is therefore far from clear that firms that could deliver substantial consumer benefits in the form of lower prices and superior service in the future would enter based on the assumption that SWBT's prices would eventually rise.

But the Mudd Affidavit is probably more revealing for what it omits than for what it includes. Nowhere does it address the special problem of SWBT's ability to cross-subsidize its competitive access prices with monopoly service prices. Nor does it address the increased likelihood of successful predation and strategic behavior where the dominant firm can price discriminate.[26] Indeed, the Affidavit does not even address the possibility that SWBT might charge below-cost prices. The Mudd Affidavit also does not address the problem that SWBT will be the supplier of essential facilities to its access competitors for the foreseeable future and therefore capable of several forms of

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24 See Mudd Aff. at 6.

25 See Areeda & Hovenkamp at ¶ 736a, b.

26 See id. at ¶ 745 ("Price discrimination reduces the costs of predation when the predator is able to reduce its price to predatory levels on only a subset of its output rather than all of it").

anticompetitive behavior (e.g., price squeezes and discriminatory access).

Finally, in addition to its reliance on the Mudd Affidavit, SWBT also argues that the Commission's rejection of Transmittal 2633 should be reversed because "[t]here is no evidence in the record . . . that competitors will be foreclosed from entering markets if SWBT is allowed to price its services as requested."[27] The obvious problem with this argument is that such evidence could only be obtained if SWBT were allowed the flexibility it seeks here. In any case, there can be no question that it is well within the Commission's authority to rely on its own predictive judgments regarding the effect pricing flexibility would have as the basis for its decision.[28]

Moreover, the Northern District of Texas decision finding Sections 271-275 unconstitutional in SBC v. FCC[29] has only

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27 Petition at 6.

28 See FCC v. RCA, 346 U.S. 86, 96-97 (1953) ("To restrict the Commission's action to cases in which tangible evidence appropriate for judicial determination is available would disregard a major reason for the creation of administrative agencies, better equipped as they are for weighing intangibles by specialization, by insight gained through experience, and by more flexible procedure. In the nature of things, the possible benefits of competition do not lend themselves to detailed forecast. . . .") (citations omitted). See also FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, 29 (1961) (In such cases, complete factual support for the [FPC's] ultimate conclusions is not required, since a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency") (citation omitted).

29 See SBC Communications Inc. v. FCC, Civ. Action No. 7-97CV-163-X, slip op. (N.D. Tex. Dec. 31, 1997).

reinforced the wisdom the Commission's predictive judgment. If, as a result of this decision, SWBT were freed from any obligation to comply with the Section 271 competitive checklist, it is far less likely to cooperate with competitive access providers in the provision of access to its network on appropriate terms and conditions. The ability to deny such fair access in combination with full pricing flexibility would make it less likely that access competition will continue to develop.

B. The Commission Has Not Precluded SWBT From Competing In Access Markets.

In its final attempt to challenge the Commission's rejection of Transmittal No. 2633, SWBT asserts that the Commission order has the practical effect of precluding SWBT from competing in many access markets. This is so, SWBT argues, because all of its competitors in the access market have the freedom to price their offerings on an individual case basis.[30] This argument is again unconvincing.

In no sense has the Commission prohibited SWBT from competing in any access markets. SWBT has considerable flexibility to respond to competitive entry through zone density pricing, volume and term discounts and the freedom to drop prices without restriction across defined geographic areas (study areas or density zones). In fact, one of the only restrictions left on ILEC access prices is the prohibition against contract tariff pricing. As the Commission acknowledged, this restriction could

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[30] See Petition at 7.

cause SWBT to lose some customers.[31] This cost was appropriately judged to be far outweighed by the risk that permitting RFP pricing flexibility would result in the exclusion of *competitive access providers* from most of the market. In any case, SWBT has offered no evidence, and the Commission had no basis for concluding, that SWBT will be precluded from competing in access markets. Indeed, the record shows quite the opposite. Access competition has been extremely slow to develop for just the reason that SWBT has effectively defended its market share.

CONCLUSION

For the forgoing reasons, SWBT offers no basis for reversing the Commission's rejection of Transmittal No. 2633.

Respectfully submitted,

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January 12, 1998

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[31] See RFP Tariff Rejection Order ¶ 54.

CERTIFICATE OF SERVICE

I, Catherine M. DeAngelis, do hereby certify that on this 12th day of January, 1998, copies of the foregoing "Opposition of Time Warner Communications Holdings Inc." were mailed, first class postage prepaid, unless otherwise indicated, to the following parties:

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